

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 92-301-W - ORDER NO. 92-1062 ✓
JANUARY 5, 1993

IN RE: Application of Heater Utilities,) ORDER DENYING
 Inc., for approval of adjustments) REQUESTED RATES
 in its rates and charges for water) AND CHARGES
 service.)

This matter comes before the Public Service Commission of South Carolina (the Commission) by way of an application of Heater Utilities, Inc. (the Company or Heater) for approval of a new schedule of rates and charges for its customers in South Carolina. The Company's July 6, 1992, application was filed pursuant to S.C. Code Ann. §58-5-240 (1976), as amended, and R.103-821 of the Commission's Rules of Practice and Procedure. The Commission granted the Company's request to waive the DHEC letter and accepted the application by Order No. 92-548, dated July 16, 1992.

By letter dated July 22, 1992, the Commission's Executive Director instructed the Company to publish a prepared Notice of Filing and Hearing, one time, in a newspaper of general circulation in the area affected by the Company's application. The Notice of Filing and Hearing indicated the nature of the Company's application and advised all interested parties desiring participation in the scheduled proceeding of the manner and time in which to file the appropriate pleadings. The Company was likewise

required to notify directly all customers affected by the proposed rates and charges.

Petitions to Intervene were filed on behalf of Steven W. Hamm, the Consumer Advocate for the State of South Carolina (the Consumer Advocate) and Sally Hinson, a customer of Heater.

The Commission Staff made on-site investigations of the Company's facilities, audited the Company's books and records, and gathered other detailed information concerning the Company's operations. The other parties likewise conducted their discovery in the rate filing of Heater.

A public hearing relative to the matters asserted in the Company's application was held on December 2, 1992, in the Hearing Room of the Commission at 111 Doctor's Circle, Columbia, South Carolina. Pursuant to S.C. Code Ann. §58-3-95 (Cum. Supp. 1991), a panel of three Commissioners composed of Commissioners Yonce, Bowers, and Arthur was designated to hear and rule on this matter. An evening hearing commenced on December 2, 1992 at 6:00 p.m. in the Commission's Hearing Room in order to give the customers of Heater an opportunity to present their views to the Commission concerning the Company's rates and service. Darra W. Cothran, Esquire, represented the Company; Carl F. McIntosh, Esquire, represented the Consumer Advocate; Ms. Hinson appeared pro se; and Marsha A. Ward, General Counsel, represented the Commission Staff.

The Company presented the direct testimony of William E. Grantmyre, President of the Company; Freda Hilburn, Director of Rates; and David Parcell, Vice President/Senior Economist of

Technical Associates, Inc. to explain the services being provided by the Company, the financial statements and accounting adjustments submitted, the reasons for the requested rates, and the cost of capital requirements. The Company submitted rebuttal testimony from these same witnesses, as well as Jerry H. Tweed, Director of Environmental and Regulatory Affairs, and Fred E. Brock, Area Manager. The Consumer Advocate presented the testimony of Philip E. Miller, Riverbend Consulting, who analyzed the Company's application and revenue requirements. Ms. Hinson presented testimony opposing the requested increase and the quality of service. The Commission Staff presented the testimony of Robert W. Burgess, Water and Wastewater Department, and Vivian B. Dowdy, Public Utilities Accountant. Several customers spoke against the proposed increase during the evening hearing.

FINDINGS OF FACT

1. The Company is a wholly-owned subsidiary of Topeka Group, Inc.¹ The Company is a water utility operating in the State of South Carolina and is subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §58-5-10 (1976) et seq. Application of Company; Grantmyre testimony.

2. The Company provides water service to approximately 3,161 customers in Richland, Lexington, Sumter, Fairfield, and Saluda Counties, South Carolina. Hearing Exhibit No. 6, Water and Wastewater Department, Part E.

1. The Topeka Group, Inc. is a wholly owned subsidiary of Minnesota Power and Light Company.

3. The Company's present rates and charges were approved by Order No. 91-881, dated October 14, 1991, in Docket No. 91-096-W. Hearing Exhibit No. 6; files of the Commission.

4. At present, the Company charges a basic facility charge of \$8.00 per single family equivalent and a commodity charge of \$3.32 per 1,000 gallons used. The Company also charges a tap fee of \$500.00 per single family equivalent.² The Company does not propose to change its tap fee. The Company proposes to change its water reconnection fee of \$30.00 to \$35.00 and increase its new customer account charge from \$22.00 to \$25.00. The Company proposes to increase its basic residential water rate to \$12.00 per month for meter sizes less than one inch³ (most residential units have a three-quarter inch meter), plus a commodity charge of \$3.67 per 1,000 gallons. Based on the average consumption of 5,866 gallons during the test year, the water increase amounts to an additional \$6.05/month or an increase of 22.02%. Application of Company; Hearing Exhibit No. 6, Water and Wastewater Department, Parts A and C.

5. The Company asserts this requested rate increase is required because the Company has experienced substantial increases in operating expenses such as property tax expense, purchased power, materials and supplies, depreciation for plant upgrades and

2. Except as otherwise prohibited by contract approved by the Commission.

3. This charge increases as the meter size increases to a 2-inch meter.

modifications, increased field service operations due to the requirements of the Safe Drinking Water Act and operating expenses. The Company has experienced for the test year ending March 31, 1992, after accounting and pro forma adjustments, a loss of \$70,325, after interest expense. The operating margin after interest expense under current rates after accounting and pro forma adjustments was (6.51%). The Company asserts that the rate increase is necessary in order for it to earn a fair rate of return on its investment, which is necessary to maintain the financial integrity of the Company. The rate increase will enable the Company to maintain the quality of service to the customers and maintain customer satisfaction. Grantmyre testimony; Application of Company, Exhibit K.

6. The Company proposes that the appropriate test period to consider its requested increase is the twelve-month period ending March 31, 1992. Hilburn testimony; Application of Company. The Staff concurred in using the same test year for its accounting and pro forma adjustments. Dowdy testimony, Hearing Exhibit No. 6. The Consumer Advocate concurred with the March 31, 1992, test year. Miller testimony.

7. Under its presently approved rates, the Company states its operating margin after interest and after accounting and pro forma adjustments is (6.51%). Application of Company, Exhibit K. The Company seeks an increase in its rates and charges for water service which would result in operating margin of 7.64%. Application of Company, Exhibit K.

8. Under the Company's presently approved rates, the Company states that its operating revenues for the test year, after accounting and pro forma adjustments, are \$1,080,438. The Company seeks an increase in its rates and charges for water service in a manner which would increase its operating revenues by \$233,177. Application of Company, Exhibit E.

9. Under the Company's presently approved rates, the Staff found that the Company's per book operating revenues for the test year were \$1,089,748, after accounting and pro forma adjustments. The Staff calculated the proposed increase to be in the amount of \$235,199. The Company did not contest Staff's adjustments except those dealing with the Company's capital structure and cost of capital. Hearing Exhibit No. 6, Accounting Exhibit A; Testimony of Grantmyre.

10. The Company asserts that under its presently approved rates, its total operating expenses for the test year, after accounting and pro forma adjustments are \$1,018,314. Application of Company, Exhibit E. Staff concluded that the Company's operating expenses for the test year, after accounting and pro forma adjustments, are \$991,070. Hearing Exhibit No. 6. Staff arrived at this proposal after making its adjustments to the Company's expenses. Based on the Company's concurrence with Staff's adjustments, except those dealing with Heater's capital structure and cost of capital, the Commission need only address those adjustments where the Company, the Staff and the Consumer Advocate disagree. Also, the Consumer Advocate raised five

individual issues through the testimony of its witness, Miller. According to the Consumer Advocate, three of the issues, salaries and wages, vehicle insurance and other insurance adjustments, and interest synchronization have been resolved to the Consumer Advocate's satisfaction during the course of the hearing. The Consumer Advocate concurred with Staff's proposed adjustments in that regard. Therefore, the adjustments at issue consist of only the Consumer Advocate's rate case expense and level of expenses issues and the Company's rate of return and cost of capital issues.

A. RATE CASE EXPENSES

Both the Staff and the Company recommended including one-third of the rate case costs associated with this proceeding, as well as one-third of the costs associated with the previous proceeding, as part of the Company's test year operating expenses. The Consumer Advocate recommended, including one-third of the cost associated with this proceeding and excluding the cost associated with the previous proceeding. The Consumer Advocate contends that it is the Commission's precedent to allow one-third of the actual rate case expense currently being incurred in filing and litigating a proceeding. Thus, according to the Consumer Advocate witness Miller, previous rate case costs, as well as the estimated costs associated with current proceedings, are not included in the allowable rate case expense.

B. LEVEL OF EXPENSES

The Consumer Advocate recommended through the testimony of witness Miller that the Company be required to submit itself to a

management audit of all of Heater's operations in South Carolina. The audit should be performed by a third party and the costs amortized over a reasonable period of time. Alternatively, Mr. Miller suggested the Commission Staff could conduct the audit. During the proceeding, Mr. Miller recommended that the Commission require the Company to justify the level of its salaries and wages in its next proceeding. Testimony of Miller.

11. The Company's records reflect that after accounting and pro forma adjustments to its operating revenues and expenses, its net operating income is (\$70,325). Application of Company, Exhibit C. The Staff calculated the Company's net operating income, after accounting and pro forma adjustments to be \$98,678. Hearing Exhibit No. 6, Accounting Exhibit A.

12. The Company has applied for rates which will result in a return on rate base of 10.12%, Application of Company, Exhibit J. Heater requested the Commission to set its rates and charges based upon the return on rate base methodology. Application of Company, Page 2; Grantmyre testimony; Parcell testimony. The applied-for rates would result in an operating margin after interest of 7.64%, according to the Company. Application of Company, Exhibit K.

13. The Commission Staff calculated the rate of return on rate base to be 10.96% and the operating margin, after interest, to be 11.28% under the proposed rates and assuming Staff's adjustments. Hearing Exhibit No. 6, Accounting Exhibit A.

CONCLUSIONS OF LAW

1. The Company is a water utility providing water service in its service area in South Carolina. The Company's operations in South Carolina are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §58-5-10 et seq. (1976), as amended.

2. A fundamental principle of the ratemaking process is the establishment of an historical test year as the basis for calculating a utility's rate base and, consequently, the validity of the utility's requested rate increase. While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. See, Parker v. South Carolina Public Service Commission, 280 S.C. 310, 313 S.E.2d 290 (1984), citing City of Pittsburgh v. Pennsylvania Public Utility Commission, 187 P.A. Super. 341, 144 A.2d 648 (1958); Southern Bell v. The Public Service Commission, 270 S.C. 590, 244 S.E.2d 278 (1978).

3. The Company chose the test year ending March 31, 1992. The Commission Staff and the Consumer Advocate used the same test year in calculating their adjustments. The Commission is of the opinion that the test year ending March 31, 1992, is appropriate based on the information available to the Commission. The test year ending March 31, 1992, is the appropriate test year for the purposes of this rate request.

4. The Commission concludes that the Staff's adjustments to the Company's operating revenues are appropriate. The Staff's adjustments recognize the annual level of revenues based on a billing analysis performed by the Company and audited by the Staff, the adjustment of late fees, and the recomputation of reconnection fees. Accordingly, the Commission finds that the appropriate level of revenues for the Company for the test year under the present rates and after accounting and pro forma adjustments is \$1,089,748.

5. The Commission also concludes that the Staff's adjustments to the Company's operating expenses are appropriate. The Commission makes this conclusion based on the following legal principles and reasoning:

A. RATE CASE EXPENSES

The Company provided an exhibit (Hearing Exhibit No. 3) which included supporting vouchers and bills submitted by counsel and its expert witnesses. The Commission concludes that this type of submittal is appropriate and is properly included for ratemaking purposes. The Commission accepts these actual rate case expenses. Additionally, the Commission accepts the rate case expenses related to Docket No. 91-096-W and amortized over three years. The Commission disagrees with the characterization by witness Miller of the Commission's policy. The Commission has allowed actual rate case expenses, including appropriate portions of any unamortized amounts from previous rate cases. The Staff's adjustment is consistent with the Commission's policy to allow rate case expenses, amortized over three years. While the Company may have

included in its operating expenses rate case expenses from two proceedings, this is not unusual, nor is it in violation of any "precedent." Therefore, amortized over three years and coupled with the other actual rate case expenses accounted for by the Staff, the total annual amortization for rate case expenses is \$17,625.20.

B. LEVEL OF EXPENSES

The Consumer Advocate's proposal through witness Miller concerning a management audit should be denied. The cost to the ratepayers would be too burdensome and the Commission Staff does not have the resources. Alternatively, witness Miller suggested that the Commission should require the Company to justify in its next proceeding its level of salaries and wages. The Commission finds that in lieu of the expense of a management audit, such a justification is reasonable. The Commission makes no finding that the Company's level of salaries and wages is excessive, rather, the Commission will require the Company to provide justification of the level of salaries and wages in its next rate filing.

C. OTHER ADJUSTMENTS

The Commission concludes that since there were no objections to the other adjustments proposed by the Commission Staff, that these adjustments, as supported by the record, are appropriate for ratemaking purposes.

5. Accordingly, the Commission concludes that the Company's appropriate operating expenses for the test year, after pro forma and accounting adjustments is \$991,070.

6. The Company's appropriate net income for return for the test year, after accounting and pro forma adjustments, is \$98,678. Based upon the above determinations concerning the accounting and pro forma adjustments to the Company's revenues and expenses, the Commission concludes that the net income for return is as follows:

TABLE A
NET INCOME FOR RETURN

Operating Revenues	\$1,089,748
Operating Expenses	991,070
Net Operating Income	\$ 98,678
Customer Growth	- 0 -
Net Income for Return	<u>\$ 98,678</u>

7. Under the guidelines established in the decisions of Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce net revenues. As the United States Supreme Court noted in Hope, a utility "has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures." However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and...that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." Bluefield, supra, at 692-693.

8. There is no statutory authority prescribing the method which this Commission must utilize to determine the lawfulness of the rates of a public utility. For a water utility whose rate base has been substantially reduced by customer donations, tap fees, contributions in aid of construction, and book value in excess of investment, the Commission may decide to use the "operating ratio" and/or "operating margin" method for determining just and reasonable rates. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues; the operating margin is determined by dividing the net operating income for return by the total operating revenues of the utility. This method was recognized as an acceptable guide for ratemaking purposes in Patton v. South Carolina Public Service Commission, 280 S.C. 288, 312 S.E.2d 257 (1984).

The Company proposed that a rate of return methodology be used as a ratemaking determinant. Witness Parcell's testimony was stipulated by the parties and addressed the appropriateness of the use of a rate of return methodology and the appropriate cost of capital for the Company. The Commission has considered the issue of applying the operating margin or rate of return methodologies for water utilities on a case-by-case basis. Each utility is unique and requires a separate review and analysis. However, in most cases involving water utilities, the Commission has employed an operating margin approach. The operating margin was used in the last case for Heater. The Commission concludes that no justification for modifying its approach has been adequately put

forth in this case. The testimony of witness Grantmyre states that use of an operating margin approach discourages needed upgrades, but the evidence shows that the Company has made a plethora of plant improvements since the last rate case. Testimony of Grantmyre. The Commission is not convinced in this case that the operating margin actually has discouraged the necessary upgrading of the utility system. There is no evidence that neither the Company's financial condition nor its ability to provide adequate service is being hampered by an operating margin approach. The Commission concludes that use of the operating margin is appropriate in this case.

Based on the Company's gross revenues for the test year, after accounting and pro forma adjustments under the presently approved schedules, the Company's operating expenses for the test year after accounting and pro forma adjustments, and customer growth, the Company's present operating margin is as follows:

TABLE B
OPERATING MARGIN

BEFORE RATE INCREASE

Operating Revenues	\$1,089,748
Operating Expenses	991,070
Net Operating Income	\$ 98,678
Customer Growth	-0-
Total Income for Return	\$ 98,678
Operating Margin (After Interest)	0.47%

9. The Commission is mindful of the standards delineated in the Bluefield decision and of the need to balance the respective interests of the Company and of the consumer. It is incumbent upon

this Commission to consider not only the revenue requirements of the Company but also the proposed price for the water service, the quality of the water service, and the effect of the proposed rates upon the consumer. See, Seabrook Island Property Owners Ass. v. S.C. Public Service Commission, Op. No. 23351 (Filed Feb. 25, 1991); S.C. Code Ann. §58-5-290 (1976).

10. The three fundamental criteria of a sound rate structure have been characterized as follows:

... (a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or consumer rationing under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.

Bonbright, Principles of Public Utility Rates (1961), p.292.

11. Based on the considerations enunciated in Bluefield and Seabrook Island and on the fundamental criteria of a sound rate structure as stated in Principles of Public Utility Rates, the Commission determines that the Company should be denied its requested rate increase. An operating margin of 0.47% is appropriate under the circumstances revealed at the hearing. No additional revenues will be granted to the Company.

12. In reaching its decision to deny the Company the requested revenues, the Commission has carefully considered the

concerns of the Company's customers. Only one customer, Sally Hinson, intervened at the hearing in opposition to the rate increase and to note problems experienced in her subdivision with the Company's service. The Commission's files contain many letters of protest. Many of the letters protest the amount of the increase and address service problems in their subdivisions. However, fourteen customers, as well as Representative Cromer, spoke at the evening hearing on December 2, 1992. The testimony elicited at the hearing was overwhelmingly in opposition to the proposed rate increase. Several testifying noted that the proposed increase to a \$12.00 per month base charge and \$3.67 per 1,000 gallons consumed would cause Heater's rates to be the highest in the State. According to Hearing Exhibit 6, Water and Wastewater Department, Part C, the average customer using 5,866 gallons per month would experience an increase from \$27.48 per month to \$33.53 per month. What concerns the Commission is that without exception, every customer testifying had experienced serious water quality problems. Customer testimony noted problems such as low pressure, staining of appliances and clothes, a clorox taste, "dirty" water, unpleasant odor to the water, undrinkable water, a slick feel to the water, and high iron content. Many customers drank bottled water and used in-home filters to make the water more suitable to their needs. Several customers complained not only of poor quality, but also of poor service by the Company.

The Commission, in considering the factors outlined above, gives considerable weight to the impact of the increase on the

customers and to the quality of service provided by the Company to its customers. Based upon the testimony of the customers, the quality of service provided by the Company is lacking. The customers of Heater should not be expected to pay the highest rates for water in South Carolina and receive service, which in many areas, is consistently problematic. The low quality of the service provided does not justify the proposed increase. Therefore, the Commission herein denies the proposed increase. The Company shall maintain its current rates and charges, as well as its current rate design. The rates designed herein consider the quality of the service provided by the Company to its customers and the need for the continuance of the provision of adequate service, as well as the impact of the increase on those customers receiving service and the need for conservation of water resources.

13. Based on the above considerations and reasoning, the Commission hereby approves the rates and charges as stated in this Order and attached hereto as Appendix A as being just and reasonable. The rates and charges approved are designed in such a manner in which to produce and distribute the necessary revenues to provide the Company the opportunity to earn the approved operating margin.

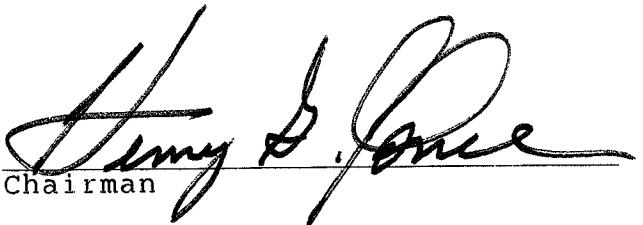
14. Accordingly, it is ordered that the rates and charges attached on Appendix A are approved for service rendered on or after the date of this Order. The rate schedule is hereby deemed to be filed with the Commission pursuant to S.C. Code Ann.

§58-5-240 (1976), as amended.

15. It is ordered that should the approved schedule not be placed into effect before three (3) months after the effective date of this Order, then the approved schedule shall not be charged without written permission of the Commission. It is further ordered that the Company maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class A and B water utilities, as adopted by this Commission.

16. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Deputy Executive Director

(SEAL)

APPENDIX A

HEATER UTILITIES INC.
104 CORPORATE BLVD.
SUITE 411
WEST COLUMBIA, S. C. 29169
796-2870

FILED PURSUANT TO DOCKET NO. 92-301-W - ORDER NO. 92-1062
EFFECTIVE DATE: JANUARY 5, 1993
Metered Rates

SCHEDULE OF RATES AND CHARGES

WATER

a. Base Facility Charge For Zero Consumption -

<u>Meter Size</u>	<u>Base Monthly Charge</u>
<1.0	\$ 8.00
1.0	\$ 22.50
1.5	\$ 45.00
2.0	\$ 72.00

b. Commodity Charge - \$ 3.32 per 1,000 gal.

Water Reconnection Charge - \$ 30.00

New Customer Account Charge - \$ 22.00

Tap Fee - \$500.00*

*Except as otherwise prohibited by contract approved by the
South Carolina Public Service Commission.